DOW THEORY LETTERS INC.

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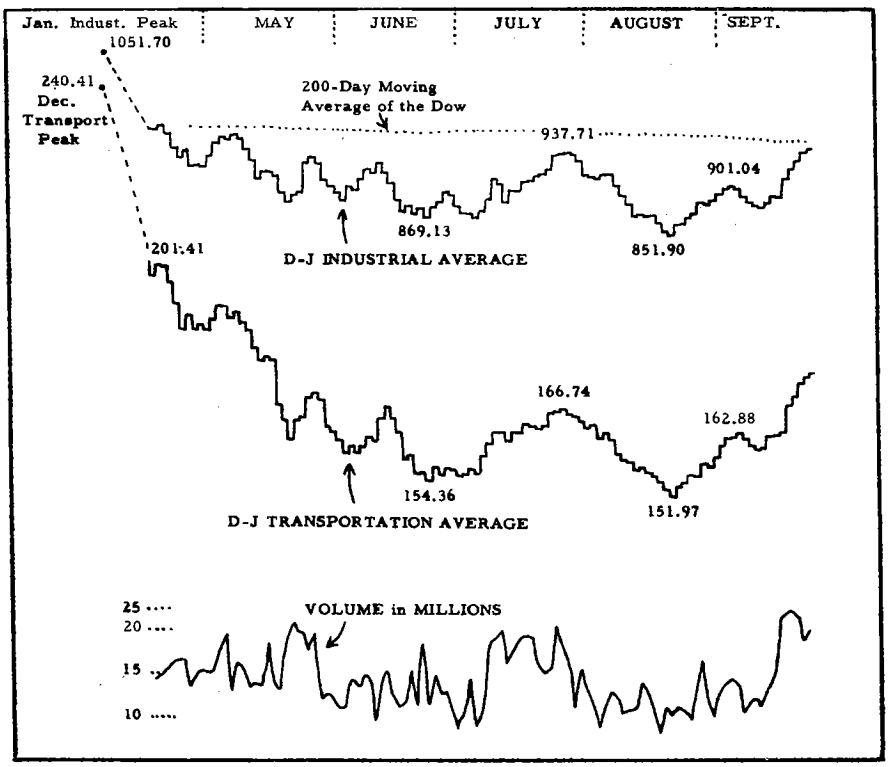
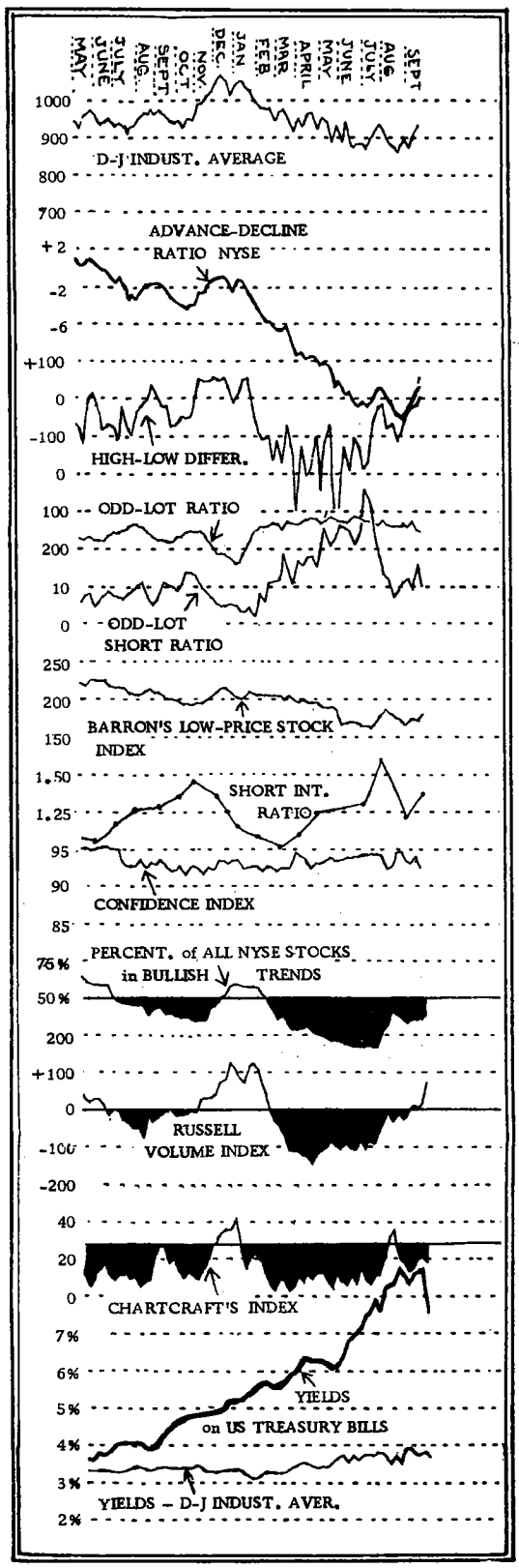
Sept. 14, DJIA 886.36; PTI 655; A-D ratio -15.00
Sept. 21, DJIA 927.90; PTI 684; A-D ratio -13.59

THE PICTURE: The stock market is made up of the thoughts, perceptions and decisions of men, and because of this I have always viewed the market as a kind of "living organism." Furthermore, I believe the stock market possesses a mysterious "unconscious," a sub-surface truth which exists apart from everything else. That mysterious unconscious does not lend itself to analysis; it cannot be graphed or charted. But it is there, and it is the factor which causes the market to move in the direction which is guaranteed to make fools of the greatest number of investors at any given time.

To recount a bit of recent history, as the year 1973 came into being, Wall Street was highly bullish. On January 1, 1973, Barron's published an article entitled, "Not a Bear Among Them," and the title meant just that (since it referred to Barron's panel of financial experts). Those of us who have been through the market's "expert-smashing" capers many times before felt a bit queasy when we read that article. Our queasiness was fully justified over the next six months as Barron's panel of experts were laid low along with the majority of stocks. In a phrase, the first half of 1973 proved a disaster for Wall Street.

Along came June and July, and the market ceased going down. New lows contracted, cyclicals held, some of the glamors appeared shaky if not toppy, but a small but growing group of technicians took the position that an important market bottom was forming. Interest rates went through the roof, inflation roared, commodities sky-rocketed, then caved in. On August 22 the D-J Industrials touched a 1973 low of 851.90; on the same day the Transports sank to their own 1973 low of 151.97. Next, a slow but steady advance began, an advance which took Industrials to 901.04 by September 6. A little decline ensued, but by September 13 the advance started anew.





On September 19 the upside "flowered" with the Dow leaping 19.11 points to the tune of 24.5 million shares for the day. On September 21 and 22 the Dow gained 10.16 and 7.37 points respectively with volume booming at over 24 million shares on each day. On September 24 (Monday) volume shrunk to 19 million shares, even though the Dow tacked on another 8.81 points, taking it exactly (and I mean exactly) to its July 27 peak of 936.71!

Thus we are witnessing part or all of a "buying explosion" on concentrated high volume. The following observations come to mind as I study this market. (1) Very high volume off the lows is usually associated with shorter upside movements, while slow, steady, "undramatic" volume off the lows is usually associated with sustained upward moves. The September rise has obviously been of the explosive-volume type. (2) As mentioned before, this rise began from simultaneous lows in Industrials and Transports. This is very atypical, and most important bottoms stem from unconfirmed lows. (3) The lows for 1973 appeared on August 22. Only once before in the history of the Averages did a yearly low appear in August, and that was in 1921 on Industrials only (Rails recorded their lows earlier in June). Thus if the lows of August, 1973, hold for both Averages, we will have made Dow Theory history, chronologically speaking.

On September 24 the Most-Active Stock Index (MAS, see Letter 574) climbed to plus 55, the high for the year. It is of interest that this lofty figure has been equalled only once (in December, 1971) in the past few years. For this reason, I feel that the market is now "overbought," and I would expect increasing strain and "raggedness" to be a characteristic as and if the market attempts further advance. I will almost surely include an MAS study in the next report, as by that time I feel MAS may be presenting a prophetic picture.

In reading a great number of advisory services this week, I come to the conclusion that the vast majority of my cohorts are simply "going with the market." Nothing wrong with that on the short term, or to put it another way, woe to him who goes against the market for the short term. On September 20 the Wall Street Journal (in their well-known "Abreast of the Market" column) set the tone when they said, "Broad bull market hinted." The huge volume since September 19 indicates that the advance has attracted many traders and institutions. The rise has been too fast for the public, so I take it that the institutions and traders are selling and switching among themselves (the public is still trying to get out from under its mutual fund morass). The fact that the public is not in this market, I regard as a neutral equation, not a bullish one, for the public has too many other things to worry about (like a current 20% rise in living costs).

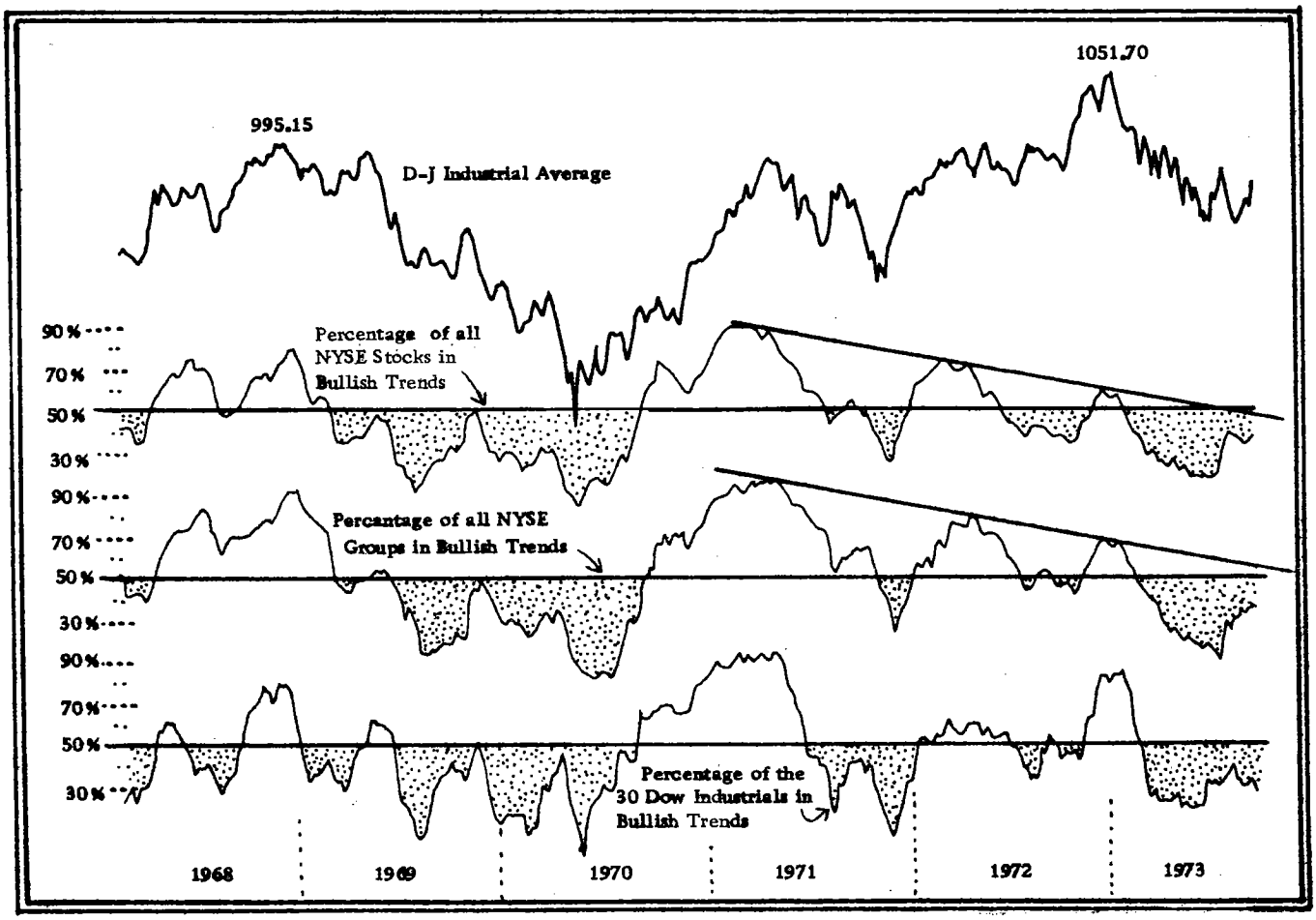
Whenever a good advance gets underway in the market (this has happened on all occasions since the 1966 bull market top) I am asked whether "this is the start of a new bull market?" At the risk of being called a spoilsport, a non-patriot, a meany, I must report that I do not consider the advance from the August 22 lows (which was the low for the D-J Industrial, Transports, Utility and A-D ratio) to be the start of a new primary bull market. I do recognize (as I have said all along) that the market was oversold during June and July, that the DJIA was down a fantastic six months in a row, that the breadth of the market had been smashed, that the worst of the daily new lows had passed.

What does all this indicate for the period ahead? In my opinion, we are now seeing another of the secondary bullish movements of the type which have appeared periodically since the 1966 top (please refer to the monthly chart from Letter 574, page 3). How far will this advance last, how far will it carry? The drop (in the Dow) from the 1051.70 peak of January 11, 1971, to the 851.90 low of August 22, 1973, was 200 points. A correction halfway back would take the Dow to 951. I am also presenting in the next section a study of the bullish percentages, and here we can see that the stage could be set for a further extension of the current market euphoria.

BULLISH PERCENTAGES: My job is never easy, but among other things I try to explain what is happening and why it is happening and how it may affect us. The history of Wall Street suggests a never-ending series of changes, pessimism to optimism, fantasy to stark reality, puritanism to hedonism, undervaluation to overvaluation. These broad changes occur to a dramatic degree in the very long swings from bull market top to bear market bottom and back to a new bull market top again. The changes occur (but less dramatically so) in the swing from a secondary peak to a secondary low and back again.

What I want to do now is attempt to put the recent and current market picture into perspective, and one of the best ways to do this is with the chart which I call my "Bullish-Bearish" indices. This chart on page 3 shows the weekly closes of the Dow Industrials together with (1) the percentage of NYSE stocks in bullish trends, (2) the percentage of all NYSE stock groups in bullish trends, and (3) the percentage of the 30 Dow Industrial stocks in bullish trends. It is important in studying the chart to remember that the situation is bullish when all three indices are above the critical 50% level, bearish when all three indices are below the 50% level. As a rule the Dow Industrial bullish percentage index will lead the others and the group bullish percentage will be the last to move.

Note that since 1968 we have witnessed four swings in the bullish percentages indices. Each one of these swings is significant and each tells a story. We had a bullish move up to the 1968 peak with all three indices registering extremely high in the bullish percentage category. Most subscribers remember the euphoria which accompanied the 1968 top, a top which saw 80%



of all NYSE issues in bullish trends and 90% of all groups bullish.

Next we saw the long, disastrous slide to the 1970 low of 631.16 on the Dow (this, of course, was a primary bear movement). At the lows, only 5% of the NYSE issues remained bullish, only 3% of the groups were bullish, while only 1 Dow stock was bullish! The gloom here was very, very thick.

From 1970's massively "oversold" bottom, we had a violent and dramatic reversal to the upside. By the first quarter of 1971 an extraordinary 90% of all NYSE issues were bullish while 96% of the groups were in bullish trends. At the same time 95% of the Dow Industrials turned bullish. Few investors realized at the time (and indeed even a year later) that the early 1971 period represented the peak of strength for the 1970-73 market. For as my chart shows, the later (1973) highs in the Dow Industrials were not matched by increasing strength in the "all-stocks" or "all-groups" indices.

In fact, the reverse was true. From the 1971 peak of strength both the all-stocks and all-groups indices formed a series of declining tops. In early 1973 the NYSE all-stock bullish percentage rose from its bearish (below 50%) reading to a feeble 58% bullish, while the all-groups index climbed from its own bearish reading to a sub-standard 67% bullish. Only the Dow bullish percentage put on a strong performance, rising to 86% bullish.

The refusal by the vast majority of stocks and groups to follow the lead of the Dow set up a technical vacuum which proved too much for the market. Despite the almost unanimous view of the experts that 1973 "had to be" a banner year, the market declined steadily for the first six months. By June and July, Wall Street was in shambles, and to add insult to injury, low volume was pressing many of the brokerage houses to the wall.

During June and July 1973, the all-stock bullish percentage hit a low of 16% while the all-group index sank to 10%. The Dow bullish percentage, acting better than the rest of the market, dropped to no lower than 30% bullish. During the third quarter and as of this writing the bullish percentages have been pushing higher. The question — what does it all mean?

A trendline analysis is very interesting. Draw trendlines connecting the 1969 and 1970 peaks in the bullish percentage indices and you will note an upside breakout during the third quarter of 1970. This strength carried through the second quarter of 1972.

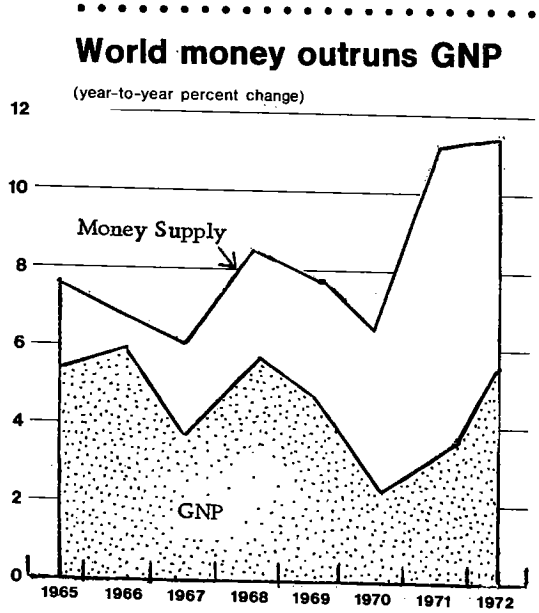
I have drawn trendlines through the three peaks which appeared during 1971 and 1972. (The bullish percentage on the Dow does not lend itself to this trendline analysis). While the bullish percentage of the all-stock and all-group indices have not yet bettered their trendlines, there is the distinct possibility that they will shortly. In both cases, a bettering of the trendline would also mean that the indices would have climbed above the critical 50% level.

If that happens, I would say that we would be in a period of market euphoria, an LSD breather for Wall Street. The market would then be saying, "Inflation, let it roll; the dollar, let it reel against the ropes as long as it hangs on; the economy, let it boom as best it can, with or without the consumer; interest rates, we're used to record interest rates and even 'new record' interest rates." The market will be saying that everyone wants to be an optimist so let's play optimist. Everything from Watergate to $127 gold has hit us this year, everything from vanishing oil reserves to asset-destroying inflation. We're still here, the market is still here, let's have another party. There's only one little problem, the piper hasn't yet been paid. (Note: bullish percentage statistics are obtained from Chartcraft's Point & Figure tabulation, Larchmont, NY 10538).

MONEY, INTEREST RATES, GOLD: In its latest monthly report the New York's First National City Bank has decided (we've known this for a long time) that the fixed exchange rate was a primary factor in world inflation. Under the fixed rate system, other nations were obliged to peg their currencies to the dollar. But the trouble was that the Federal Reserve System allowed enormous expansion of dollars. These dollars then splashed all over the world, many going into the various foreign central banks as reserves. Presto, excess liquidity in these nations and international inflation.

Even so, the system stayed alive as long as confidence remained in the dollar. When the confidence collapsed, so did the whole Bretton Woods fixed exchange system. From there, the so-called "float" took over, with the market itself determining the value of the various currencies. As First National puts it, "So the Bretton Woods system began to drown in the liquidity which its own built-in permissiveness had helped to create."

The accompanying chart (from a First National City chart) shows what has been happening to world money in relation to world GNP. What the chart shows is that world money supply is rising at almost double the rate of world GNP. This, obviously, creates galloping inflation as increasing amounts of paper chase the world's supply of goods.



I am borrowing a second most interesting set of figures from First National, showing annual rates of depreciation of various currencies, or, to put it another way, the various rates of monetary inflation. Now, it is obvious that a continuation of the recent and current trends must lead to chaos. Once people start planning for next month's and next year's inflation, the whole monster starts feeding on itself, but at a more rapid rate. Thus, we have amazement and consternation here and throughout the world as each new inflationary set of wholesale and consumer price indices are released.

One of the results of the current virulent inflation is that leading nations are beginning to realize that they must gain control of their money stock. This means severe restraint, both on the interest rate front and as to bank reserves.

A second set of problems fits into the same framework. As everyone now admits, the two dollar-devaluations and the subsequent further weakening of the dollar due to speculative sales of greenbacks had the effect of plunging the dollar too far on the downside (at least on a temporary basis). Suddenly, a "cheap dollar" was the catchword throughout the world, and the dollar began to rally against other currencies (it should be remembered, however, that all currencies had plunged in terms of gold). As the other major currencies sank, their various basic weaknesses began to surface. Interest rates (which are used to protect currencies) around the world rose to staggering heights.

	Industrialized countries				
	Indexes of value of money (1962=100)		Annual rates of depreciation of money		
	1967	1972	'62-'67*	'67-'72*	'73†
United States	91	72	2.0%	4.4%	4.7%
Sweden	80	63	4.3	4.7	5.8
Luxembourg	86	71	2.9	3.7	6.2
Canada	88	72	2.6	3.8	6.3
France	85	65	3.2	5.3	6.3
New Zealand	84	61	3.4	6.2	6.4
Australia	88	71	2.6	4.1	6.6
Belgium	84	69	3.4	3.8	6.6
Germany	87	73	2.7	3.6	6.8
Austria	84	68	3.4	4.1	7.1
Norway	82	61	3.9	5.7	7.1
Denmark	75	56	5.6	5.7	7.2
Netherlands	79	59	4.5	5.7	7.3
Switzerland	83	67	3.6	4.1	7.4
Spain	67	51	7.6	5.5	7.8
United Kingdom	85	62	3.2	6.2	7.8
Finland	75	58	5.6	5.1	8.3
Japan	76	57	5.3	5.6	8.5
South Africa	86	70	2.9	4.1	8.6
Italy	79	65	4.6	3.7	8.7
Portugal	83	54	3.7	8.1	8.9
Ireland	82	57	3.9	7.1	9.8
Turkey	72	44	6.4	9.4	10.6
Iceland	60	33	9.6	11.4	14.8
Yugoslavia	48	28	13.6	10.2	16.7
Median rates			3.7	5.3	7.3

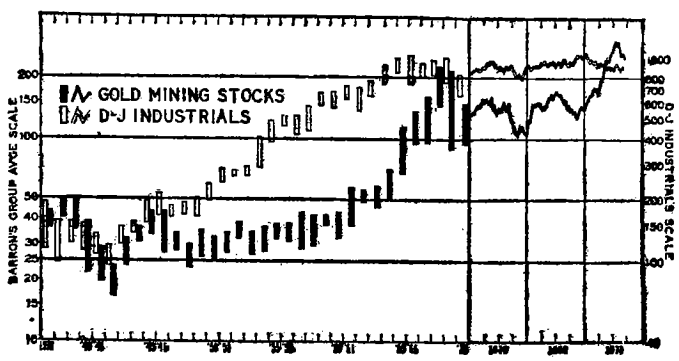
The pound suffered fainting spells, as British interest rates ran up to 12%. The lira weakened drastically. But then a dramatic turn of events occurred. First New Zealand revalued its currency upward by 10% (against the dollar), then Australia revalued its currency by 5%. But when Holland revalued the guilder by 5% a run began on the already weakening French franc. Amid disturbing rumors of a franc devaluation, the French boosted their bank rate to a 100-year high of 11%, and various nations moved to support the franc. But the realization was dawning on the world (in the face of three revaluations upward against the dollar) that the greenback still may not be the super-bargain that it was advertised to be.

On September 26 yields on 91-day T-bills plunged to 7.3%. The indications are not totally clear yet, but there is evidence to suggest that the Fed is in the process of letting up on short-term interest rates. If so, I feel that we have seen one of the most mindless exhibitions of the Fed blowing "warm and then cool" on record. The Fed must decide whether to use its power to force a recession, thereby at least attempting to fight inflation — or to "let 'er rip," thereby allowing an inflationary explosion and subsequent cave-in. So far, the run to record-high interest rates and then relaxation has proved nothing, solved nothing. Maybe we should simply get used to all that and stop trying to make sense out of anything the government does! Is the whole episode just one more example of the government spouting piously — but accepting inflation to even the hint of recession? It seems unbelievable, but the answer would (so far) appear to be "Yes."

Almost before it started, the IMF meeting in Nairobi fizzled. The current meeting "agreed" to agree at the next meeting set for July, 1974, and US Treasury Secretary Shultz admitted that this meeting was "procedural rather than substantive." As far as this monetary safari is concerned, I will admit to allowing my imagination to play tricks on me. I actually thought "something" might happen at Nairobi, beyond a free ride at tax-payers expense and a sight-seeing tour for 3,500 attendees. What I forgot is my own rule, which states that "Politicians never do anything until their back is against the wall, and then they do whatever minimum is required in order to get the critics off their back." Obviously, I place the IMF attendees in the politician class.

At the IMF meeting the usual propaganda did take place, mixed with generous portions of hopes and fantasies. It was stated that SDR's would be the coming standard, rather than the dollar. It is thereby hoped that "paper gold" (SDR's) will serve as an international reserve or base for money. Such a plan could conceivably have worked twenty years ago, when confidence in paper money ran very high. But today, with the paper currencies of the world suffering various sinking spells against gold and each other, the idea of making IMF paper the bedrock for the rest of the world's paper is beyond belief. I give it no chance of working, none at all. It simply confirms what every psychologist knows, men tend to believe what they want to believe.

I am including a little chart which appeared in the September 24 issue of Barron's, and I first showed this chart in Letter 568. Here we see Barron's Gold Average and the D-J Industrials (both plotted in monthly ranges). Note that since 1943 the Gold Average held below the Dow. But this relationship changed in 1973, for the first time in a third of a century, and even the current correction in the golds sees the Gold Average above the price of the Dow. Thus, the Dow (which is based strictly on dollar values) has not kept up with gold (which is based on dollars as related to gold). The chart cuts through all the talk and fantasy. It is making a very clear statement of comparative values.

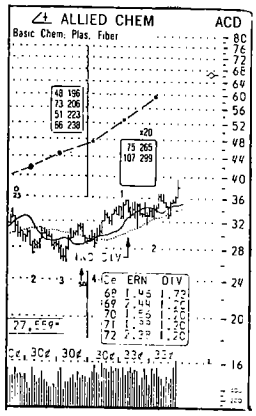


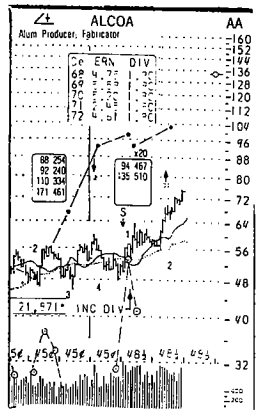
A sign of the times: Bank of Rothschild has issued over $100 million of bonds based in "Eurco's." A Eurco is worth about $1.29 and is made up of a number of currencies. The theory is that if one of the currencies collapses, it will be hedged by the others. Thus, no one will get stuck with a single deteriorating paper currency.

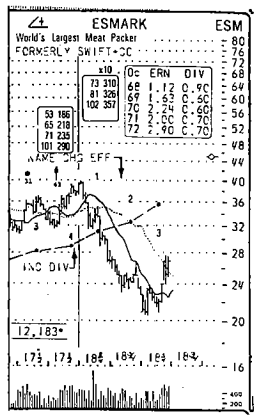
STOCKS: Dividend declarations by S. African gold shares are nothing short of sensational. Most of these were based on the mines selling less than 100% of output (they are currently selling almost all their output, so earnings ahead could be even higher). Here are some 1973 dividend totals (before the 15% S. African withholding tax, which is tax deductable). F.S. Geduld $3.06 in '73 against $2.54 in '72. Pres. Brand $2.24 against $1.61. Pres. Steyn 75¢ against 40¢. West. Holdings $4.79 against $3.71. Welkom 75¢ against 48¢. Regardless of current disinterest and anti-gold propaganda, the fat dividends are now proving a strong support for the S. African gold shares. Average current yield on the five issues listed above is 12%.

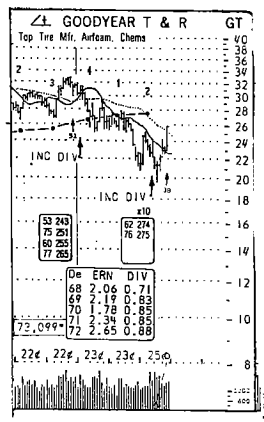
On my latest technical tabulations of the Dow stocks (scale of zero, the weakest, to 5, the strongest), six stocks are in a high four zone. These are Allied Chemical, Alcoa, Esmark, Goodyear, Int. Paper, Owens-Illinois. Surprisingly, there are

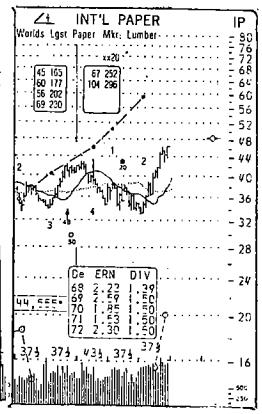
10 Dow stocks in the low zero or 1 category. The zero's are Amer. Can, Amer. Brands, Kodak, Proctor and Gamble, Westinghouse. I have been listing the strongest stocks for some time now, suggesting that traders confine their action to these issues. That still holds, under my theory that if the Dow goes up, certain stocks in the Dow must go up, and the job is to pick the strongest issues. I include weekly charts of the strongest Dow stocks, and again I say, confine speculation to these stocks. Charts courtesy of Quote, PO Box 213, Wichita, Kansas 67201.

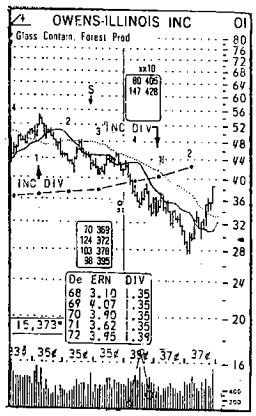






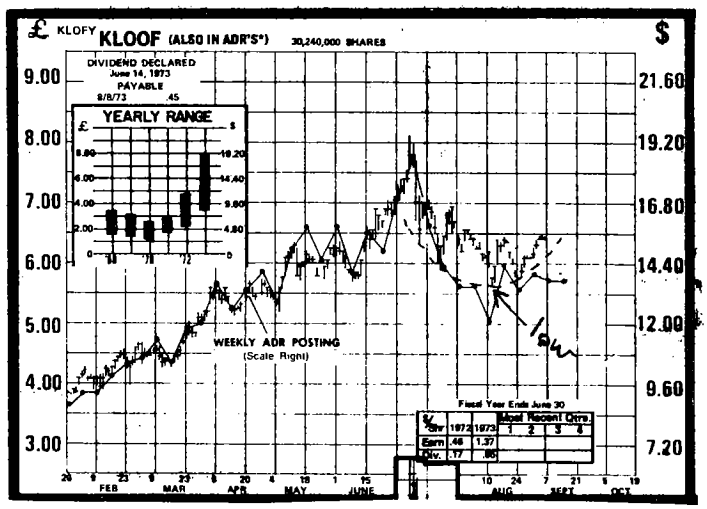


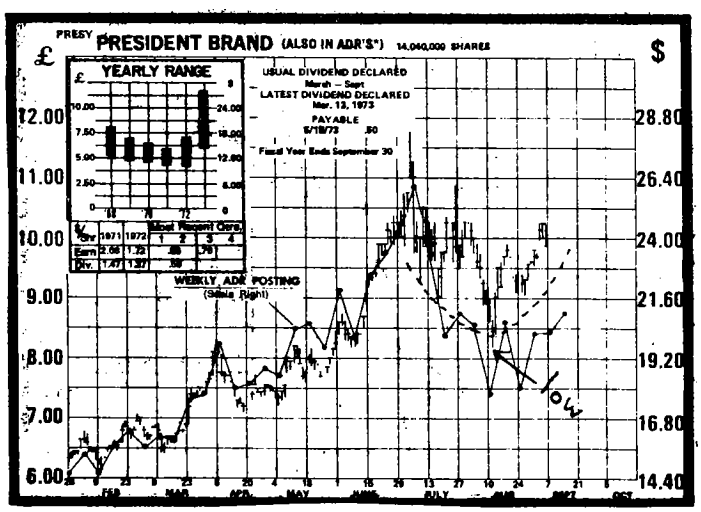




LATE MARKET NOTES: On September 25 the Dow closed over 940 (over its July peak) with Transports also over its July high. The Primary Trend Indicator, however, is still far below its July peak, and thus we have the first technical problem. On the same day, the Most-Active Stock Index rose to plus 57, the highest figure in years. I expect the relationship of the Dow and the PTI to assume real importance in the period ahead, and this will be detailed in the next mailing.

I have included two representative S. African gold stocks showing daily movements in London and in ADR's (ADR's are the dots connected by lines). The charts are courtesy of Kaffir Charts, Palisades Park, NJ 07650. Referring to London fluctuations, I feel that the Kaffirs have passed their lows and are forming rounding bottoms. They have discounted all the anti-gold news, but it could take time for them to complete major bottoms. Note that Pres. Brand has already made up better than half of its correction-losses, a good sign.





PLAINTIVE NOTE: Once more I must beg readers not to expect answers to letters they write. Sometimes I get as many as six to ten letters a day, each with questions and often questions I could write pages in response to. I love to get the letters, I appreciate receiving clippings and info from around the world, but I haven't got the strength to answer them all. This does NOT mean that I don't enjoy reading ALL letters...

FOR DOG LOVERS: While at a local hamburger palace a few nights ago, I noticed a large, ferocious-looking dog of a species I have never seen before. It appeared to be a mixture of English bull dog and pony. The dog took a strange liking to me and followed me home. I have not been able to locate its owner. In referring to a dog encyclopedia, it seems clear that I have inherited a full-grown bull mastiff, which I understand is a rare dog, used by British kings during the 19th century to patrol their hunting grounds. I can now recommend bull mastiffs to all subscribers who are unsure of their physical safety and who are too lazy to take up Karate. When walking down the street I note that people step off onto the curb rather than pass too close to "Crunch," as I have named her. Actually, she is friendly, but nobody will get near enough to her to find out.